

CIA/OER/IM 71-42 WORLD GOLD MARKET

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DIRECTORATE OF  
INTELLIGENCE

# Intelligence Memorandum

*The World Gold Market In 1970 And Prospects For 1971*

*International Finance Series No. 26*

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CENTRAL INTELLIGENCE AGENCY  
Directorate of Intelligence  
March 1971

INTELLIGENCE MEMORANDUM

The World Gold Market In 1970  
And Prospects For 1971

Introduction

This memorandum, one of a series begun shortly after the two-tier gold market was established in March 1968, reviews and updates developments in both the official and private tiers of the world gold market through December 1970. Attention is focused on the official gold reserve position of the United States and on South Africa's gold marketing activities. The outlook for gold in 1971 is also considered.

1970 Highlights

1. After a substantial increase in US gold reserves during 1969, the first in 12 years, US monetary gold stocks fell by \$790 million from the end of 1969 to the end of 1970. Most of this decline can be attributed to two large sales to the International Monetary Fund (IMF).

2. The Republic of South Africa, again beset with large payments deficits, sold gold worth more than \$1.6 billion\* -- nearly \$480 million more than production and nearly \$400 million more than

\* This and subsequent dollar amounts are calculated at \$35 per troy ounce of fine gold.

*Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.*

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in 1969. Approximately 57% went to the free market, mostly via the Union Bank of Switzerland. This level of free market sales was considerably lower than had been anticipated after the conclusion of the December 1969 Agreement between South Africa and the IMF.\* The reason for this was that the fall of the free market price below the official level of \$35 per ounce early in the year allowed South Africa, under the provisions of the agreement, to sell substantial quantities to the IMF.

3. Free market prices fluctuated in a narrow range over the course of the year. At the official level for the first two and a half months, the price -- with the exception of a short period in May -- remained below \$36 per ounce through August. Normal seasonal demand and a flurry of discussion about the future of gold pushed the price of gold above \$36 in September 1970. By October the Swiss banks were manipulating the market by encouraging speculation while presumably withholding gold from the market. In a matter of weeks, prices soared more than \$2.50 to over \$39 an ounce, but subsequently fell below \$37 on a daily basis, then rose to about \$37.50 where they stabilized for the remainder of the year.

#### The Official Market for Gold

4. US monetary gold reserves reached a two-and-one-half-year high in mid-1970, but declined during the remainder of the year. In the last five months of 1970, US gold reserves fell \$860 million from the July high to \$11.07 billion, their lowest level since April 1969. Much of this decline is explained by two large transfers to the IMF.

5. First, the IMF purchased a net \$321 million of US gold in September: the Fund cashed in \$400 million in interest-bearing US Treasury securities

\* For details, see ER IM 70-23, The World Gold Market In 1969 And Prospects For 1970, February 1970, SECRET/ [REDACTED]

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for gold;\* this gold was then sold to several member countries, including the United States. Then, in late December, the United States deposited \$385 million in gold with the IMF to cover the increment in the 25% gold tranche of its 1970 IMF quota increase.\*\* Normally, this type of reduction in gold reserves will be reflected in an offsetting increase in a country's gold position with the IMF. In this case, however, the United States acted as a gold supplier for other countries seeking additional amounts of gold to cover their gold tranche increases.\*\*\*

6. Other official US transactions during 1970 were relatively small. Purchases from US stocks of \$218 million less sales to the United States by foreign central banks of \$135 million resulted in a further decline of \$83 million in US gold reserves. Purchases from the United States were generally small. Of the 31 countries involved, three accounted for 73% of the total: Taiwan (\$59.8 million), the Netherlands (\$50 million), and Switzerland (\$50 million). The Dutch and Swiss purchases reflect an increase in dollar reserves during the year, to levels the Dutch and Swiss found excessive, while the Taiwanese transaction facilitated the payment of a longstanding debt to the IMF. Nine countries sold gold to the United States during the year; three of them -- Spain (\$50.8 million), Kuwait (\$24.9 million), and

\* In 1956, 1959, and 1960 the IMF invested a total of \$800 million in interest-bearing US Treasury securities for gold to obtain operating income and to provide a reserve toward meeting possible future deficits. By 1970, IMF earnings from these securities were considered large enough so that half of them could be resold to the US Treasury.

\*\* The US quota was increased, according to an IMF resolution adopted 9 February 1970, from \$5,160 million to \$6,700 million. The \$385 million gold sale represents the portion of the quota increase that must be paid in gold -- that is, 25% is the "gold subscription."

\*\*\* These sales totaled \$548 million; the major purchasers being France (\$129 million), Japan (\$119 million), India (\$30 million), and Mexico (\$25 million).

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Burma (\$20.7 million) -- accounted for nearly 71% of total 1970 central bank sales to the United States.

South African Gold Sales in 1970

7. Faced with a record payments deficit for the second year in a row, South Africa in 1970 sold its entire output of newly mined gold as well as some previously accumulated. Total sales of \$1.6 billion exceeded current output by nearly \$480 million (see Table 1). While much of this gold entered the free market, a much larger than anticipated portion (approximately 43%) was sold to the IMF and other monetary authorities.

8. During 1970, South African gold sales to monetary authorities totaled \$689 million; all but \$49 million went to the IMF. Under the provisions of the December Agreement, South Africa may sell a specified amount of gold to monetary authorities, primarily the IMF, under the "price formula." This occurs when the free market price, as reflected in the two daily London fixings, is at or below \$35 per ounce. Sales under this criterion were about \$125 million. South Africa may also sell gold to the IMF at \$35 per ounce less a handling charge under the "deficit formula" -- that is, to cover any payments deficits during semi-annual periods after treating newly mined gold as an export. Sales under this formula were almost \$350 million. Finally, South Africa was allowed to sell small amounts of gold quarterly from reserves accumulated prior to the establishment of the two-tier system. Eligible sales under this provision were exhausted during the fourth quarter of 1970.\* Although large sales under the deficit formula were anticipated, the lengthy period of depressed free market prices (early January through mid-March) enabling South Africa to sell \$125 million under the price formula was unexpected.

\* The \$168 million sold under this provision also includes an ad hoc \$34.8 million reflecting an earlier commitment to Pretoria by the IMF.

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Table 1

South African Gold Reserves  
as of 31 December 1970 a/

	Million US \$
Reported reserves (31 December 1969)	1,115
Production (1970)	1,130
Supply before sales	<u>2,245</u>
Sales	
To the IMF (under December Agreement)	640
Including:	
Price formula	124.7
Deficit formula	347.0
Pool	168.3
To other monetary authorities	49
Including:	
French IMF rand drawing	22
Mozambique	4
Switzerland	23 <u>b/</u>
To the free market	919
Total sales	<u>1,608</u>
Reserves (31 December 1970)	666
Unexplained difference <u>c/</u>	29

*a. For consistency in analysing reserve data, values are calculated at \$35 per troy ounce of fine gold.*

*b. Swiss share of South African gold under the December Agreement.*

*c. Possibly obtained from South African Chamber of Mines.*



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The Free Market for Gold

9. South Africa's free market sales during 1970 totaled \$919 million (815 metric tons, see Table 2).<sup>\*</sup> Although the Union Bank of Switzerland continued to purchase the lion's share (755 tons),<sup>\*\*</sup> 60 tons were probably sold to non-Swiss customers. While positive identification of these purchasers has not been made, there is evidence that some of this gold was purchased by London banks and bullion dealers. More than 60% of the Union Bank total was purchased f.o.b. Johannesburg and flown to Switzerland aboard aircraft operated by Balair, a Swissair subsidiary. The remainder, shipped by sea to England, was flown from London to Zurich.

10. Although free market prices moved in a rather narrow range during much of 1970, the pattern of these movements gave rise to suspicions that Union Bank was attempting to manipulate the market. The year began with prices at just slightly above \$35 an ounce and almost immediately the price fell several cents below this level (see the chart). Through mid-March, free market prices hovered at or near \$35 per ounce. Thus, while South Africa was selling much of its newly mined gold to the IMF under the price formula provisions, the free market price indicated virtually no increase in demand for gold at a time when jewelers and artisans would normally start replenishing their inventories.

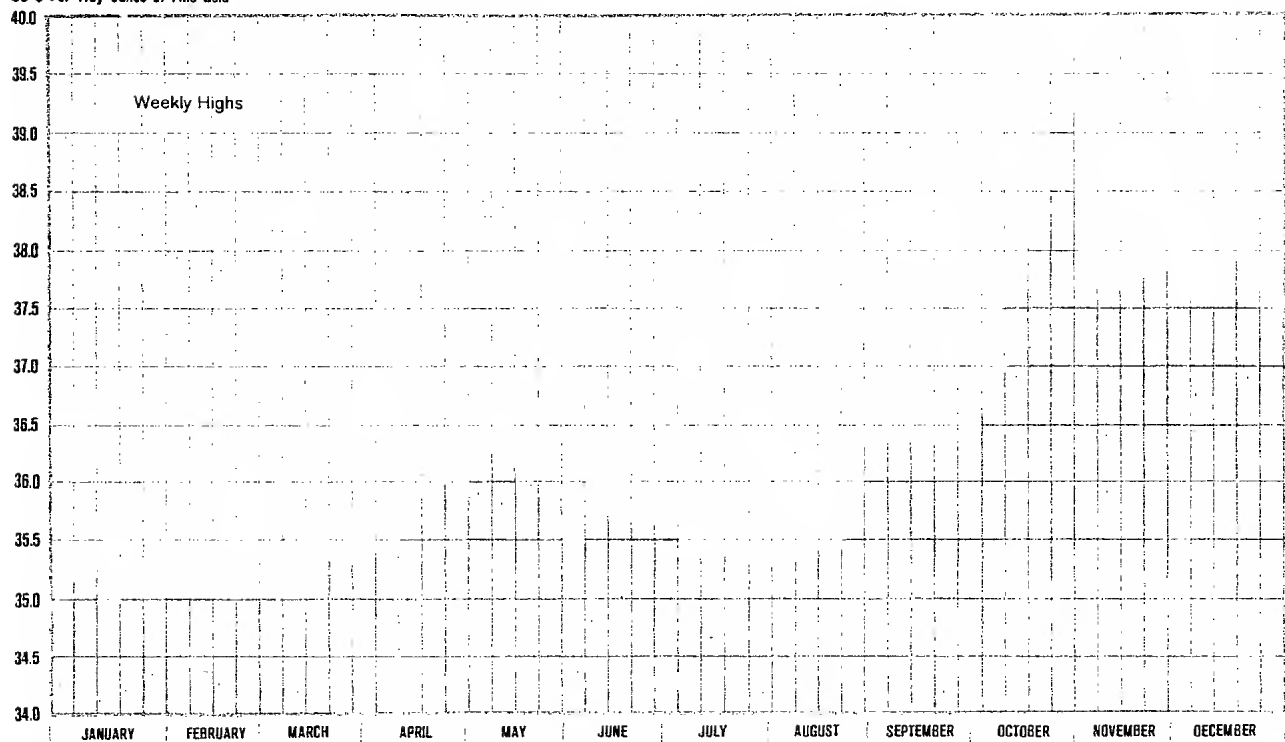
<sup>\*</sup> The actual price paid South Africa averaged nearly \$35.75 per ounce for the year, an amount approximately 25 cents below 1970's mean free market price. Such a premium over the official price would provide South Africa with an additional foreign exchange of about \$20 million.

<sup>\*\*</sup> After the establishment of the two-tier system, Zurich's three largest banks, Union Bank of Switzerland, Swiss Banking Corporation, and the Swiss Credit Bank, formed a consortium to purchase newly mined South African gold. In mid-1969 the bullion manager of Swiss Credit Bank, convinced that gold at that time was a poor investment, withdrew from this consortium by selling virtually all of his bank's gold on the free market. At present, the Swiss consortium appears to be in operation once again with the Union Bank still playing the dominant role.

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### London Weekly Gold Prices, 1970

US \$ Per Troy Ounce of Fine Gold



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Table 2

South African Free Market Gold Sales  
1970

<u>Month</u>	<u>Metric Tons</u>	<u>Million US \$ <sup>a/</sup></u>
January	31	35
February	0	0
March	46	52
April	91	102
May	90	101
June	94	105
July	100	113
August	85	96
September	70	79
October	87	98
November	61	69
December	60	68
<i>Total</i>	<i>815</i>	<i>919</i>

*a. Based on the official price of \$35 per troy ounce of fine gold.*

11. After mid-March the price gradually rose, reaching a peak of just slightly above \$36 per ounce for a few days in May. Subsequently, however, the price retreated approximately 75 cents where it remained through August. By September, prices began moving upward again in response to a seasonal increase in demand from the jewelry trade and Middle Eastern hoarders. Then in mid-October the price jumped more than \$2 in about a week. Although some of the October rise can be attributed to the proliferation of studies and speeches heralding a new era for gold, it was mainly caused by a drop in gold supply. The Union Bank of Switzerland probably withheld from the market all or most of the South African gold being received. This policy was successful in forcing a sharp rise in the free market price until the point at which offerings from hoarders became too large to absorb. Consequently, the free market

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price settled back to the \$37.50 level by the end of October where it remained relatively unchanged throughout the rest of the year.

### Outlook

12. South Africa's estimated balance-of-payments deficit for 1971, although smaller than the record 1970 shortfall, will still be in a range of \$200-\$300 million after including sales of all newly mined gold as exports.\* Since there is little likelihood that the free market price will fall to \$35 per ounce -- a condition which would allow South Africa to sell a portion of its newly mined gold to the IMF -- virtually all of South Africa's 1971 gold output -- \$1.1 billion at \$35 per ounce -- will enter the free market. The deficit will be covered by gold sales of \$200-\$300 million to monetary authorities, primarily the IMF, from reserves now in the vaults of the South African Reserve Bank. Accordingly, South African gold reserves could fall to about \$370 million by the end of 1971.

13. Free market gold demand principally for industrial purposes and normal hoarding (mainly in less developed countries) will probably be on the order of \$1.6 billion in 1971. The free market supply will probably be approximately the same as demand. Gold output of Free World producers other than South Africa is estimated at \$300 million while another \$150-\$200 million should be available from the hoards accumulated during the 1967-68 run on the London Gold Pool at prices not far above \$35 an ounce. Thus, unless the Zurich banks are able to manipulate the market successfully, the free market price seems likely to remain under \$40 per ounce during 1971. During the first two months of 1971, the price was usually in the \$38.00 - \$38.80 range.

\* For analysis, see ER IM 71-22, South Africa: Balance-Of-Payments Prospects, February 1971, CONFIDENTIAL/ [REDACTED]

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14. The outlook for the official tier is less bright. Impatience with large US balance-of-payments deficits, which seems certain to occur again in 1971, has increased abroad, particularly among European central bankers. They are likely to redeem dollars for gold at a much faster rate in 1971 than was the case in 1970.

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